

ROLE OF RESERVE BANK OF INDIA IN REFORM PERIOD

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Abstract:

Indian economy has gone through various reforms since two decades. Reforms came into picture from LPG policy and continued till today. Indian economy has become volatile economy. During this reform period, Reserve bank of India has performed crucial role. RBI is considering long run as well as short run perspective impact of reforms on economy. RBI is playing significant role in managing such activities by adopting various menace and advances. Without intervention of RBI it would have become very difficult to survive in dynamic environment. The research paper aims at providing information about the impact of such policies undertaken by RBI during 2008-2013.

Key Words: RBI, Reforms, Indian Economy, LPG Policy.

Introduction:

Indian economic system has become volatile economy since 1991 when India opened its door for rest of the world by following Liberalization, Privatization and Globalization Policy. Indian economy has faced various challenges after introduction of LPG Policy and it has to get reformed to cope up with international environment. During 2008-2009 entire world has faced Great depression due to fall of Lehman Brother in USA which had impact on various developing economies including India. Reserve Bank of India which is the central bank of India has played intellectually vigorous role for controlling economic conditions. Research Paper is aiming to find out various challenges faced by economy during 2008-2013 which was the crucial reform period. Researcher has deliberately selected this period because this is rigorous period which was having large number of fluctuations in economy.

Objectives of the study:

The Research Paper has the following objectives:

- 1) To understand post reform challenges
- 2) To analyse measures taken by RBI
- 3) To study impact of measures on economy

Scope of the Study:

The Research Paper has considered various speeches delivered by Governor, Deputy Governor and other eminent personalities. The time span taken for study is also limited i.e. from 2008-2013.

Research Methodology:

The Research Paper is based on secondary data and method applied is historical and descriptive method. Source of information are:

- Publications of RBI
- Website of RBI
- Internet and
- Speeches of eminent personalities.

Reserve Bank of India:

Reserve Bank of India was established by Reserve Bank of India Act 1934. RBI is one of the strongest central bank in the world. RBI makes macroeconomic policy that is having impact on general public. RBI is managed by unelected officials appointed by the government of India and it is an apolitical central bank which is operating autonomously within a prescribed set of rules and regulations. For this research paper researcher will be focusing on last five years period.

Challenges During Post Reform Period:

Indian economy has faced various challenges after Reform Period and RBI has played intellectual role in managing such a challenges. Before initiating to study the role of Reserve Bank of India it will be good to know challenges faced by Indian economy during post reform period which can be explained as follows:

1. Recession of the year 2008 and Inflation:

The sudden failure of Lehman Brothers in September 2008 is widely viewed as a watershed moment in the global financial crisis of 2007-2009. With over \$639 billion in assets and \$613 billion in liabilities, the Lehman Brothers' bankruptcy was the largest in United States history. It was the largest shock for economy of USA and later on it spread over the entire world. This was due in large part to Lehman Brothers' extensive global footprint in the debt. They also lent excessive money without considering capacity of borrower. It resulted in adverse way the prices of houses were felt down and there were no demands for loans of banks and financial institutions. And the second worst thing was security provide by borrowers was having less value than amount lent, it created problem on recovery by banks and financial institutions. Lehman Brothers' global footprint meant that thousands of financial market participants were directly impacted by its collapse. In addition, numerous aftershocks were felt throughout the world resulting from numerous cross-border and cross-entity interdependencies.

Inflation went into negative territory for a brief period in mid-2009, started rising in late 2009, and had remained around 9-10 per cent for all of 2010 and much of 2011, reflecting both supply and demand pressures. The supply shocks and demand pressures combined to trigger a wider inflationary process. Our economy was caught in the central banking dilemma of balancing growth and inflation. Though India was facing the impact of Lehman Brothers and other economies were shutting down, our economy could survive because of strongest central bank.

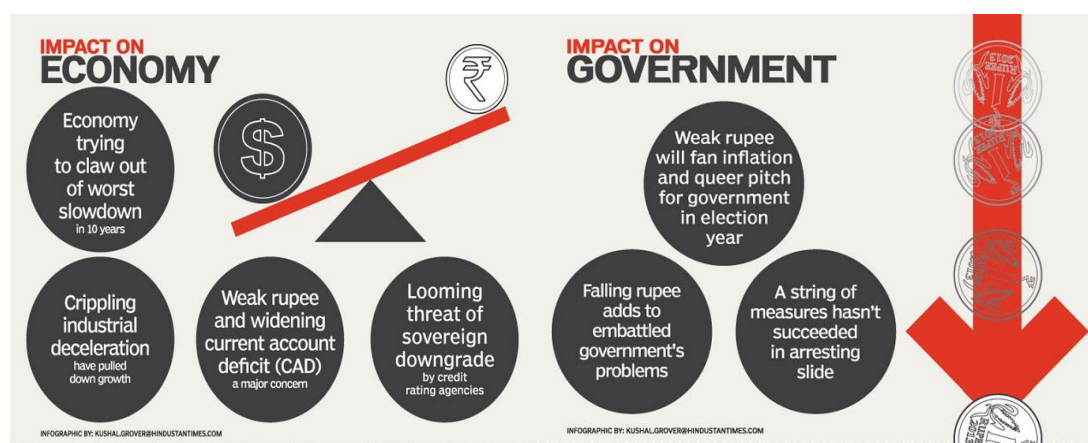
2. Current Account Deficit:

Current Account Deficit (CAD) means when value of import of goods and services is greater than value of goods and services exported. CAD rises when aggregate demand exceeds aggregate supply. It is problem in front of our Indian economy that percentage of CAD is continuously raising. If it continuous it will affect adversely on the economy of the country. A substantial Current Account Deficit is not bad thing for certain countries as it can be used for increasing productivity in short term. Import of Crude Oil and Gold are putting high pressure on CAD. Whereas Food Security Bill passed by Parliament this year may put additional burden on Current Account. India's current account deficit touched a record high of 4.7 per cent of the GDP or \$88 billion in the last fiscal. India's gross domestic product

growth decelerated to a ten year's low of 5 per cent in fiscal 2012-13, but RBI expects the economy to grow at 5.5 per cent this fiscal, down from its May projection of 5.7 per cent.

3. Rupee Dollar Price Fluctuations:

It is one of the most important challenges in front of Indian economy. Dollar inflows to Indian economy are falling due to global problems such as improvements in policies of Federal Reserve Bank of USA. Due to decreasing rate of dollar against rupee, investment made by Financial Institutional Investor is running out from Indian market. Various businesses which are based on import are facing the problems because they have to make payment in dollars. Dollar is having more demand compared to rupee. Experts say that rupee has been devalued by 23 per cent from its inception against the dollar. The fall in price of rupee will be affecting on consumers, government as well as on the economy which can be shown as follows:



4. Implication of BASEL III

BASEL III is a global standard on bank adequacy, stress testing and market liquidity risk. It is prepared by the Basel Committee on Banking Supervision and introduced from 2013 to 2015. BASEL III was supposed to remove the deficiencies of BASEL I and BASEL II by strengthening by increasing bank capital requirements. The BASEL III is also criticised on the basis of risk that it would decrease GDP growth by 0.05-0.15 per cent. Government of India has to inject additional capital for the banks for implication of banks. The will have to recapitalize public sector banks with an estimated Rest. 900 billion or be ready to reduce their

equity in banks below 50 per cent to comply with the BASEL III norms of 4.5 per cent common equity.

5. Financial Inclusion:

Financial Inclusion is the delivery of financial services at affordable cost to vast sections of disadvantaged and low income groups of society. Financial inclusion is about ensuring 5A's

Adequacy → Availability → Accessibility → Awareness → Affordability

It is next challenge for RBI in reforming period to bring entire population of India under wings of banking through financial inclusion. However illiteracy and low income savings and lack of bank branches in rural areas create problems in implementation of Financial Inclusion. Over 150 million accounts opened by the customers, whereas only 30 million are operating accounts opened with the banks. Though we have accepted the LPG policy and we are in the world of Globalization, 40 per cent of Indian population is still outside of the purview of banking services. This creates big challenge in front of Indian government.

Besides the above challenges, Indian economy has to face other challenges also which can be named as Increasing efficiency of banks, Financing of infrastructure, Increase in amount of frauds, Money Laundering, High amount of Corruption, unstable political conditions, withdrawal of FDI, Control over inflation, increasing foreign exchange reserve etc. When reform took place, companies who were not in position to compete with the international organizations had to close. However, those who are surviving have to face keen competition from outsiders by providing standard quality goods and services. That means reform period is helpful for development of Indian economy. Actually Reform period was started from the year 1991 on the recommendation of Narasimham Committee. In order to better understand the trends during reform period in India may be divided into distinct phases based on various internal and external developments which impacted the banking sector.

- **Phase 1 (Pre-1995):** This phase represents the period immediately after the economic reforms. Besides the challenges posed by the changes in business environment due to the reforms, banks also had to adjust to changes in regulatory norms.

- **Phase 2 (1996-2001):** This was a period of stabilization post reforms and was characterized by developments like computerization, formulation of strategies for technology implementation, challenges of NPAs and banks approaching markets for capital.

- **Phase 3 (2002-2007):** This was the growth phase when the impact of reforms was fully felt. This period was characterized by technology upgradation by banks, benefit of global liquidity and a period of growth. This was also the phase of build-up of risks due to the irrational exuberance exhibited by market players.

- **Phase 4 (2008-2013):** This last phase is dominated by the global financial crisis and post crisis pains. The risks building up in the previous phase crystallized during this period. The period is also characterized by reforms fatigue, lack of banking penetration, absence of internal reforms and ineffective structure, systems and people.

However for study purpose it can be further divided into three phases which can be listed as follows:

Phase	Period	Title/Name of Phase
Phase I	2008/09	Crisis Management
Phase II	2010/11	Exit from the Crises
Phase III	2012/13	Pressures on External Sector

Role of RBI during reform period:

1. Recession of the year 2008 and Inflation:

Overcoming of inflation, RBI reversed the Monetary Policy of October, 2009 and started to strengthen the policies. In the year 2010 and 2011 most of the world was in crises of full boom and was having great amount of uncertainty. RBI had a classic V-shaped recovery from the crisis, that growth had not dipped in the Lehman crisis year as low as had been feared, and that growth in the subsequent two years was stronger than earlier thought.

2. Current Account Deficit:

Repo rate was the instrument used by RBI to control the inflation, rise in price level s and coming out of Crises period. RBI has done Repo rate cuts of 125 bps between April 2012 and May 2013, CRR cut of 200 bps and open market operations (OMOs) of `1.5 trillion last year. The objective of monetary tightening was to compress aggregate demand, and so some sacrifice of growth is programmed into monetary tightening. But that sacrifice was only in the short-term; there was no sacrifice in the medium term.

3. Rupee Dollar Price Fluctuations:

Rupee depreciation have been due to the markets factoring in 'tapering' by the US Fed, but RBI is having both in the diagnosis and remedy, if RBI does not acknowledge that the root cause of the problem is domestic structural factors. At its root, the problem is that RBI have been running a current account deficit well above the sustainable level for three years in a row, and possibly for a fourth year this year. Basic economics says that the current account deficit rises when aggregate demand exceeds aggregate supply. Reducing the current account deficit requires structural solutions - RBI has policy space or instruments to deliver the needed structural solution. They fall within the ambit of the government. In the interim, RBI has stabilized the market volatility by using some measures.

4.Implications of Basel III

The cost of Basel III is certainly is going to cost in terms of growth across the world and even in emerging economies. All estimates agree that Basel III will impose costs only in the short term. The costs will disperse over time and in the medium to long term the benefits of Basel III by way of financial stability and by way of a crisis prevention, will outweigh the higher costs of credit. At board and management levels, managers have to improve their skill and competence in risk management. At all levels, banks and the Reserve Bank have trying to become knowledge institutions. So, the message out of Basel III is that banks have to become knowledge institutions.

5. Financial Inclusion:

Financial inclusion has to be a subset of wider economic inclusion. It is important to generate revenue for economic inclusion for sustainable inclusion. Financial inclusion would be possible if there is a felt need for financial services and for this banks need to have both model and motivation to convert this to sustainable business opportunities. Financial inclusion is about viable and sustainable business models with focus on accessible and affordable products and processes, synergistic partnerships with technology service providers for efficient handling of low value, large volume transactions and appropriate regulatory and risk management policies that ensure financial inclusion and financial stability move in tandem.

Impact of Measures on Economy

Low and steady inflation is a necessary precondition for sustained growth. Any growth sacrifice in the short term would be more than offset by sustained medium term growth. RBI had run a tight monetary policy because it does care for growth. Our capital account measures were aimed at encouraging inflows and discouraging outflows. RBI has tightened liquidity at the short end to raise the cost of short-term money so as to curb volatility. At the same time, RBI did transmission of the interest rate signal from the short end to the long end as that would hurt flow of credit to the productive sector of the economy. There are two problems banks face in financing infrastructure. The first is exposure risk, how much can a bank expose itself to a company or a group of companies whose main business is infrastructure. The second problem is asset liability mismatch because funding of banks is short term while lending for infrastructure is long term. While improving the efficiency of Indian banks, financial intermediation was a little acknowledged. In common parlance, we attribute that growth acceleration to a number of factors, like productivity improvement, entrepreneurial spirit, increase in savings, demographic profile etc. But one of the less recognized drivers of performance of India's growth was the improvement in the quality and quantum of financial intermediation. Just one statistic - bank credit as a ratio to GDP - went up from 22% in March 2000 to 50% in March 2011. So, in a period of 11 years, credit-GDP ratio has more than doubled. The operating efficiency continued to improve even during the last two years of global turbulence. Note that when the world was going through a crisis, the operating efficiency of Indian banks continued to improve.

Conclusions:

The RBI has managed both economic and regulatory policies in a globalizing world. The global financial crisis, the Eurozone sovereign debt crisis as well as the currency market volatility over the last few months have emphatically demonstrated how external developments influence our domestic macroeconomic situation in complex, uncertain and even capricious ways. The Reserve Bank makes analytical and intellectual rigour policies that exploit the advantages of globalization and mitigate its risks.

Reserve Bank of India must be in a position to work as a knowledge institution. The crisis has shown that knowledge matters. Those central banks which are at the frontiers of domain knowledge and are pushing the envelope in terms of policies and actions will be

better equipped to deal with the complexities of macroeconomic management in an increasingly dynamic and interconnected world.

Reserve Bank of India is having impact on every day's life. The Reserve Bank has to remain a useful and relevant institution only if it is able to understand the hopes and aspirations of ordinary people and factor them into its policy calculus. Reserve Bank of India is more conscious than before that the policies it makes have a meaning if, and only if, they make a positive difference to the real world.

Like in most other developing economies, the Reserve Bank was not born autonomous; it gained its autonomy over time as a result of the lessons of international experience and the maturity of our political executive who saw the benefits of preserving the autonomy of the Reserve Bank. The Reserve Bank of India Act does not prescribe any formal mechanism for accountability. Over the years, however, certain good practices have evolved. The Governor holds a regular media conference after every quarterly policy review which is an open house for questions, not just related to monetary policy, but the entire domain of activities of the Reserve Bank.

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